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No. 97-1868

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In the
Supreme Court of the United States

OCTOBER TERM, 1998

UNUM LIFE INSURANCE CO. OF AMERICA,
Petitioner

v.

JOHN E. WARD,
Respondent

On Writ of Certiorari to the
United States Court of Appeals for the Ninth Circuit

BRIEF FOR RESPONDENT

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QUESTIONS PRESENTED

1. Whether the California "notice-prejudice" rule, which prevents an insurance company from avoiding payment of benefits on the basis of untimely notice of the claim unless the insurer can establish that it has been substantially prejudiced by the delay, is a state law that "regulates insurance" and is therefore saved from preemption by Section 514(b)(2)(A) of ERISA, 29 U.S.C. § 1144(b)(2)(A).

2. Whether general state law principles of agency — under which an employer may, if the insurer chooses to involve the employer in administration of an insured benefits plan, be deemed the agent of the insurance company — "relate to" an ERISA plan within the meaning of the ERISA preemption clause, Section 514(a), 29 U.S.C. § 1144(a).

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STATEMENT OF THE CASE

Respondent John E. Ward's career as pr esident and CEO of Management Analysis Company ("MAC") ended in May 1992 as a result of severe pain caused by diabetic neuropathy. Since then Ward has been permanently disabled and unable to work.

MAC maintained a long-term disability plan for its employees, which qualified as an employee welfare plan under § 3(1) of the Employee Retirement Income Security Act ("ERISA"), 29 U.S.C. § 1003(1). MAC administered the plan, which provided benefits by purchasing a disability insurance policy from petitioner UNUM Life Ins. Co. of America. Ward had premiums for disability coverage deducted from his paycheck during his entire nine-year tenure with MAC. (Pet. App. 28a.) The plan (which is simply UNUM's policy) provides that written notice of a claim must be given to UNUM within 30 days of the onset of disability, if possible, or as soon as it is reasonably possible to do so. (Pet. App. 42a, 43a.) Written proof of claim is due, at the latest, 180 days after the onset of disability. (Pet. App. 43a, 5a.)

When Ward left MAC he had hoped that his health would improve enough to permit him to return to work, but his health deteriorated further and he was unable ever to work again. (Jt. App. 20, 21.) By December 1992, Ward's physicians informed him that his disabling medical condition was permanent. (Jt. App. 21.) In February 1993 he applied to California for state disability benefits, and his application was granted in late February or early March of 1993. (Jt. App. 19.)

Ward then notified MAC's Vice President for Administration, Dexana MacQuarrie, that he was disabled and inquired about benefits. (Jt. App. 19.) She advised him of his rights under COBRA to extend his health insurance coverage in light of his permanent disability. (Jt. App. 19.) In a letter to Ward dated March 30, 1993, MacQuarrie wrote: "Dear John: I was disappointed to hear that your condition is not improving

and is now considered a permanent disability." (Jt. App. 23.) The letter explained that, in order to qualify for extended health insurance coverage, Ward would have to obtain a determination from the Social Security Administration that he was disabled and would have to notify MAC of the determination. (Jt. App. 24.)

Ward did as instructed and by July 1993 he had obtained a determination from Social Security that he was permanently disabled as of May 10, 1992. (Jt. App. 21.) He forwarded a copy of the determination to Maria Bonney, a benefits administrator at MAC, in July 1993. (Jt. App. 19, 21.) On prior occasions Bonney had advised MAC employees who became disabled of the existence of MAC's own disability insurance program and of the need to file a claim with UNUM, and she had forwarded claim forms to several employee-claimants. However, she never advised Ward that he might seek benefits under MAC's plan. (Jt. App. 25, 26, 28.) Bonney testified that she simply did not think about whether Ward might be eligible for disability benefits under MAC's plan. (Jt. App. 28.) Vice President MacQuarrie's testimony was similar. When asked why she did not advise Ward about disability benefits under MAC's plan she explained: "It never occurred to me — the subject of [Long-Term Disability] never crossed my mind." (Jt. App. 22.)

In April 1994, while he was cleaning out a safe-deposit box, Ward found a booklet describing MAC's "Long Term Disability Income Benefits" policy. (Pet. App. 28a.) He immediately contacted Bonney at MAC to inquire why he was not covered by the plan. *Id.* She advised him that he was indeed covered and sent him an application for benefits. (Pet. App. 28a, 29a.) Ward completed the application and sent it back to MAC. (Pet. App. 29a.) MAC then completed the employer section and sent the application to UNUM on April 11, 1994. UNUM advised Ward on April 13, 1994, that it would not even review his claim because it was not submitted within the policy's time limits. (Pet. App. 29a.) Ward retained counsel, who requested on June 6, 1994, that UNUM review its denial of Ward's claim.

(Pet. App. 29a, 90a.) UNUM confirmed its denial of coverage only six days later. (Pet. App. 29a.)

Proceedings in the District Court.

Ward filed suit under ERISA in federal court to recover benefits under the policy. (Pet. App. 3a.) UNUM filed an answer on its behalf and on behalf of the MAC plan. (Pet. App. 4a.) Ward argued that under *Elfstrom v. New York Life*, 67 Cal.2d 503, 432 P.2d 731(1967), an employer who administers a group insurance plan for an insurer is the insurer's agent. Ward contended that since MAC was the plan administrator it was UNUM's agent under *Elfstrom*, and as a consequence Ward's notice to MAC in March 1993 that he was disabled constituted timely notice under the plan. (Pet. App. 7a.)

The district court held that the *Elfstrom* rule "related to" ERISA plans and was therefore preempted under Section 514(a), and was not saved from preemption by the saving clause, Section 514(b)(2)(a), 29 U.S.C. §§ 1144(a) and 1144(b)(2)(A) (Pet. App. 30a-31a.) The district court granted UNUM's motion for summary judgment, finding that Ward's claim, though sympathetic, was late, and UNUM therefore was not obligated to honor it. (Pet. App. 33a.)

The Ninth Circuit's Decision

Ward filed a timely appeal and the court of appeals reversed, holding that its decision in *Cisneros v. UNUM Life Ins. Co.*, 134 F.3d 939 (9th Cir. 1998) (petition for cert. pending, No. 97-1367) required reversal and a remand for application of the California notice-prejudice rule. (Pet. App. 5a, 6a.) That rule prevents an insurer from avoiding liability on the basis of untimely notice or submission of proof unless the company can prove that it has sustained actual and substantial prejudice as a

result of the delay. *Cisneros,* 134 F.3d at 944.[1] The court instructed the district court to remand the case to the plan administrator to determine whether the plan had suffered prejudice because Ward's claim was late. (Pet. App. 6a.)

The Notice-Prejudice Rule

In *Cisneros* the court of appeals held that although the California notice-prejudice rule "related to" ERISA plans under Section 514(a) of ERISA, it was a law that regulated insurance and was therefore saved from preemption by ERISA's saving clause, Section 514(b)(2)(A). 134 F.3d at 944. Following *Metropolitan Life Ins. Co. v. Massachusetts*, 471 U.S. 724, 740-743 (1985), and *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41 (1987), the Ninth Circuit determined that the California notice-prejudice rule "effectively creates a mandatory contract term" and therefore regulates the insurance relationship between insured and insurer. 134 F.3d at 946. As in *Pilot Life* and *Metropolitan Life*, the court first determined that the notice-prejudice rule "regulated insurance" from a "common-sense" view, because it regulated the terms of insurance policies and was directed specifically at the insurance industry. 134 F.3d at 945.

Next, the court of appeals checked its conclusion against three criteria developed in the case law interpreting the phrase "business of insurance" under the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015. In *Metropolitan Life,* 471 U.S. at 743, this Court noted that *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982), had "identified three criteria relevant to determining whether a particular practice falls within that Act's reference to the 'business of insurance'":

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[1] *See, e.g., Shell Oil Co. v. Winterthur Swiss Ins. Co.*, 12 Cal.App.4th 715, 760, 15 Cal.Rptr.2d 815, 845 (1993); *Clemmer v. Hartford Ins. Co.*, 22 Cal.3d 865, 881-882, 151 Cal.Rptr. 285, 293-95 (1978.)

> [F]irst, whether the practice has the effect of transferring or spreading a policyholder's risk; second, whether the practice is an integral part of the policy relationship between the insurer and the insured; and third, whether the practice is limited to entities within the insurance industry.

Pireno, 458 U.S. at 129.

The Ninth Circuit determined that the notice-prejudice rule satisfied the second and third *Pireno* factors because the rule was integral to the relationship between the policyholder and the insurer and applied only to the insurance industry. 134 F.3d at 946. The court further found that although the rule did spread costs, it did not appear to spread risk as that term had been discussed in *Pireno. Id.* Nevertheless, the court held that a state law could regulate insurance even if it did not spread risk. It read *Metropolitan Life*, *Pilot Life*, and *Pireno* as treating these three criteria as "relevant considerations or guideposts, not separate essential elements of a three-part test that must each be satisfied for a law to escape pre-emption." 134 F.3d at 946.[2]

The *Elfstrom* Rule

After determining that the judgment against Ward would be reversed and the case remanded, the court of appeals undertook an alternative analysis of the case based on Ward's argument that MAC was UNUM's agent under *Elfstrom*. (Pet.

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[2] In holding that a state law that did not spread risk could still regulate insurance the court of appeal disagreed with the Fifth Circuit, which had held that a law that did not spread risk did not qualify as a law that regulates insurance, and was necessarily preempted. *See Tingle v. Pacific Mutual Ins. Co.*, 996 F.2d 105, 110 (5th Cir. 1993); *CIGNA Healthplan v. Louisiana*, 82 F.3d 642, 650 (5th Cir. 1996), *cert. denied*, 519 U.S. 964 (1996); *Cisneros*, 134 F.3d at 946.

App. 7a.) The court determined that ERISA did not preempt *Elfstrom* in light of this Court's recent decisions in *New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645 (1995), and *Cal. Div. Of Labor Enforcement v. Dillingham Construction Co.*, 117 S.Ct. 832 (1997). (Pet. App. 20a.) The Ninth Circuit reasoned that the *Elfstrom* rule was not preempted because it did not govern plan structure or create an alternative enforcement mechanism, and it meshed smoothly with fiduciary responsibilities imposed by ERISA. (Pet. App. 21a-22a.)

Although UNUM's policy contains a term disclaiming MAC's agency, the court of appeals held that the existence of an agency relationship was a question of fact, and was not controlled by how the policy characterized it.[3] (Pet. App. 14a, 15a.) In treating the existence of an agency relationship as a question of fact the court declined to apply *Elfstrom* literally. *Elfstrom* held that "the employer is the agent of the insurer in performing the duties of administering group insurance policies." 67 Cal.2d at 512, 432 P.2d at 737. A literal application of this rule would have required the court to find that MAC was UNUM's agent as a matter of law because it was the plan administrator. The court declined to make this finding, instead remanding to the district court for a factual determination of the nature of the relationship between UNUM and MAC. (Pet. App. 25a.)[4]

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[3] The court held that "whether a particular relationship is that of agency does not depend on what the parties call it, and the parties cannot, where the relationship is in fact one of agency, change its nature by declaring that it is not an agency . . . ." (Pet. App.15a, citing, *inter alia*, 2A C.J.S: Agency, § 7 (1972).)

[4] The court instructed that this issue need not be addressed on remand unless the notice-prejudice issue was resolved adversely to Ward. (Pet. App. 25a.)

SUMMARY OF ARGUMENT

I. The two questions presented in this case are independent. The judgment below must be affirmed if respondent Ward prevails on either one. The first issue is whether California's notice-prejudice rule, which Ward agrees "relates to" ERISA plans within the meaning of ERISA Section 514(a), is a state law that "regulates insurance" and is therefore saved from preemption by ERISA's saving clause, Section 514(b)(2)(A). In *Metropolitan Life* this Court recognized that, as a matter of common sense, laws that regulate the terms of insurance policies "regulate insurance." The notice-prejudice rule plainly does this because it alters the terms of insurance policies by overriding notice requirements unless the insurer can show prejudice, thereby changing the relative rights of insurer and insured under the contract. Indeed, this alteration of the terms of UNUM's policy is the gravamen of UNUM's complaint about application of the notice-prejudice rule.

UNUM asserts that the rule is derived from generally applicable doctrines, like the harmless error rule, and therefore that it is not directed toward the insurance industry. But the relevant California cases reveal a distinct and peculiar lineage for the notice-prejudice rule, which has always been exclusively a regulation of insurance contracts. UNUM cannot cite a single application of the notice-prejudice rule outside of the insurance context.

The notice-prejudice rule also satisfies the three factors used to determine application of the McCarran-Ferguson Act, which this Court employed in *Metropolitan Life* to buttress its common-sense analysis. UNUM argues that the notice-prejudice rule does not regulate insurance because it does not spread risk. UNUM is mistaken, but even if it were not, UNUM itself concedes that many state laws that do not spread risk have nonetheless been held by this Court to be laws regulating the business of insurance. Moreover, UNUM's premise that a state

insurance regulation must meet all three of the McCarran-Ferguson factors is wrong. This Court has expressly disavowed any application of the factors as a rigid three-part test; it has instead consistently applied the factors as mere guides or considerations to be weighed in the overall common-sense determination of whether a state law regulates insurance.

UNUM contends that, even if it falls within the saving clause, the notice-prejudice rule nevertheless conflicts with ERISA's exclusive civil enforcement scheme because it makes possible a late claim for benefits. But Ward's complaint invokes only the benefits remedy expressly provided by ERISA itself. While California's notice-prejudice rule alters the terms of UNUM's insurance policy and expands the circumstances where coverage is available, as the saving clause permits, it does not create a new remedy to recover those benefits.

Much of UNUM's brief is devoted to decrying the expense and disruption that may arise (1) from subjecting multi-state plans to differing state regulations and (2) from having a different regulatory regime apply to self-funded plans than to insured plans. But as this Court has frequently explained, Congress itself created both of those disuniformities in ERISA by preventing states from regulating self-funded plans while saving state insurance laws from preemption.

II. Ward assumes arguendo that the particular doctrine announced by the California Supreme Court in *Elfstrom v. New York Life,* under which an employer is deemed to be its insurer's agent as a matter of law, may well be preempted because it "relates to" ERISA plans. But that is irrelevant because the Ninth Circuit did not apply the *Elfstrom* rule in this case. Rather, by remanding the case for a factual inquiry into whether MAC functioned as UNUM's agent, the court below applied California's general principles of agency law. Those principles do not "relate to" ERISA plans and therefore are not preempted. State laws that indirectly affect plans by altering the market

incentives they face, or that prescribe the consequences of the organizational choices made by plans, do not "relate to" the plans. Here, California agency law sets forth the consequence for an insurer that chooses to involve another entity in administering its policy, but agency law does not bind the insurer to any particular arrangement for administration of its policy.

Mackey v. Lanier Collection Agency & Service, 486 U.S. 825 (1988), established that the meaning of "relates to" does not change depending upon which party is invoking the state law in question, or upon the type of lawsuit in which that rule is invoked. Because ERISA obviously would not preempt application of general agency principles to a plan in a garden-variety tort or contract suit brought by a plan creditor, such principles should not be deemed suddenly to "relate to" an ERISA plan simply because the suit is brought by a plan participant.

ARGUMENT

I. THE NOTICE-PREJUDICE RULE "REGULATES INSURANCE" AND IS THEREFORE SAVED FROM PREEMPTION BY THE ERISA SAVING CLAUSE.

Under the ERISA preemption clause, Section 514(a), ERISA's terms "supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan." 29 U.S.C. § 1144(a). However, ERISA's insurance saving clause, Section 514(b)(2)(A), provides that "nothing in this sub-chapter shall be construed to exempt or relieve any person from any law of any state which regulates insurance." 29 U.S.C. §144(b)(2)(A). The saving clause thus "returns to the States the power to enforce those state laws that 'regulate insurance.'"

FMC Corp. v. Holliday, 498 U.S. 52, 58 (1990).[5] Because California's notice-prejudice rule "relates to" ERISA plans under Section 514(a), the only remaining issue under the first question presented is whether that rule "regulates insurance" under Section 514(b)(2)(A) and is therefore saved from preemption.

A. The Notice-Prejudice Rule Meets This Court's "Common Sense" Test As a Law That Regulates Insurance.

1. The notice-prejudice rule dictates the terms of insurance contracts and regulates the relationship between the insurer and its insured.

In its unanimous decision in *Metropolitan Life*, this Court established a common sense test for whether a state law "regulates insurance," 471 U.S. at 740, based on the "plain language of the saving clause," *id.* at 744, and concluded that state laws that regulate the content of insurance policies are within the scope of the saving clause. Thus in *Metropolitan Life* the Court held that "mandated benefit" statutes, which require that all insurance policies provide certain benefits, are state laws that regulate insurance. Specifically, the Court first observed, "To state the obvious, [the statute under review] regulates the terms of certain insurance contracts, and so seems to be saved from preemption by the saving clause as a law that 'regulates insurance.'" *Id.* at 740.

[5] The saving clause is, in turn, modified by the so-called "deemer" clause, which prevents a self-funded ERISA plan from being deemed an insurer or engaged in the business of insurance "for purposes of state laws 'purporting to regulate' insurance companies or insurance contracts." Section 514(b)(2)(B), 29 U.S.C. §1144(b)(2)(B) (Pet. App. 14a.) *See FMC Corp. v. Holliday*, 498 U.S. at 58. This case does not involve a self-funded ERISA plan, so there is no issue concerning application of the "deemer" clause.

The Court then explained that this "common-sense view of the matter" was "reinforced by the language of the subsequent subsection of ERISA, the 'deemer clause,'" which refers specifically to state laws "purporting to regulate . . . insurance contracts." 471 U.S. at 740.

> By exempting from the saving clause laws regulating insurance contracts that apply directly to benefit plans, the deemer clause makes explicit Congress' intention to include laws that regulate insurance contracts within the scope of the insurance laws preserved by the saving clause.

Id. at 741.

The ERISA saving clause preserves California's notice-prejudice rule because that rule, "by requiring the insurer to prove prejudice before enforcing proof-of-claim requirements. . . . effectively creates a mandatory contract term. The rule dictates the terms of the relationship between the insurer and insured, and consequently is integral to that relationship." *Cisneros*, 134 F.3d at 946.[6]

Indeed, UNUM concedes that the notice-prejudice rule regulates the terms of its disability insurance policy. UNUM's very complaint — which it italicizes — is that the notice-prejudice rule caused its insurance policy's "'written terms [to be] *altered*.'" (Pet. Br. 10, 32-33) (emphasis and brackets by petitioner). The alteration is plainly of considerable import to both the insured and the insurer because it can affect whether or

[6] As the Solicitor General points out, the only reason ERISA's preemption clause is even implicated in this case is because the notice-prejudice rule "relates to" ERISA plans insofar as it "in effect requires plans to include particular provisions (in this case, regarding the enforcement of claim filing deadlines) in their insurance contracts." Brief for the United States ("U.S. Br.") at 8-9.

not benefits are paid under the policy, which is of course the core concern of any insurance contract. *See United States Dept. of the Treasury v. Fabe*, 508 U.S. 491, 503-504 (1993). The notice-prejudice rule, "as a matter of common sense," therefore "'regulates] insurance.'" *Cisneros*, 134 F.3d at 945.

UNUM appears to argue that the ERISA saving clause does not protect the notice-prejudice rule because it is "merely a common-law rule," rather than a statute. (Pet. Br. at 23; 22-24) (urging that Congress meant to preserve only "'any law *enacted* by any State for the purpose of regulating'" insurance)(emphasis by petitioner). This distinction is foreclosed by the statute itself. ERISA defines the state insurance regulations it preserves as "all laws, decisions, rules, regulations, or other state action, having the effect of law, of any State." 29 U.S.C. §§ 1144(c)(1) and (2). Common-law rules developed by state courts, like California's notice-prejudice rule, therefore qualify under ERISA as "state law" and are saved from preemption if they "regulate insurance." *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 48 n.1 (1987).

UNUM also argues that because the notice-prejudice rule, unlike a mandated benefit statute, does not define the scope of coverage in the insurance contract, it affects only policy administration and therefore is not "substantive." (Pet. Br. 28.) Assuming *arguendo* that the rule relates purely to claims "administration," this label is a UNUM creation found nowhere in ERISA, and it therefore has no bearing on the scope of the ERISA saving clause.[7] In *Metropolitan Life* this Court included

[7] The saving clause makes no distinction between state laws that regulate "substantive" terms and those that regulate claims processing or administration. A state law that prohibited insurance companies from denying medical claims as "medically unnecessary" unless that judgment was made by a physician, would relate to policy administration, but it would surely also be a state law that "regulated insurance" and was therefore saved from preemption.

in its description of laws that "regulate insurance" laws that regulate such claims administration practices as "grace periods" for complying with insurance policy deadlines. 471 U.S. at 728 n. 2. This is consistent with the Court's observation in *SEC v. National Securities, Inc.*, 393 U.S. 453, 459 (1969), upon which the Court relied in *Metropolitan Life*, that the entire purpose of the McCarran-Ferguson Act[8] was "to assure that the activities of insurance companies in dealing with their policyholders would remain subject to state regulation."

> "The relationship between insurer and insured, the type of policy which could be issued, its reliability, interpretation, and enforcement — these were the core of the 'business of insurance.'"

Metropolitan Life, 471 U.S. at 743-44 (quoting *National Securities*, 393 U.S. at 460).

This Court has consistently refused "to read limitations into" the ERISA saving clause beyond those imposed by Congress itself. *Metropolitan Life*, 471 U.S. at 741. In that case the insurer and its *amici* argued that the saving clause should include only "traditional insurance laws," such as laws regulating sales practices, but should not protect "laws that regulate the substantive terms of insurance contracts." *Id.* The Court rejected that proposed amendment of the saving clause, holding that "[i]f a state law 'regulates insurance,' . . . it is not preempted. Nothing in the language, structure, or legislative history of the Act supports a more narrow reading of the clause." *Id.* at 746.

[8] The McCarran-Ferguson Act contains language, at 15 U.S.C. § 1012(b), that parallels the ERISA saving clause, and which serves the same federal policy — permitting the states to regulate the insurance business. *Metropolitan Life*, 471 U.S. at 744 n.21.

There is no reason, however, to accept UNUM's characterization of the notice-prejudice rule as "administrative" rather than "substantive." The rule does not impose any obligation on the insurer about how to process claims. Instead, it changes the relative rights of the parties to the insurance contract by limiting the circumstances that permit the insurer to deny coverage. And this substantive alteration of the policy is, after all, the gravamen of UNUM's objection to the notice-prejudice rule. (See Pet. Br. 11, 32-33.)

2. The notice-prejudice rule is directed expressly and exclusively at insurance companies.

"A common-sense view of the word 'regulates' would lead to the conclusion that in order to regulate insurance, a law must not just have an impact on the insurance industry, but must be specifically directed toward that industry." *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 50 (1987). In *Cisneros*, the court below held that California's notice-prejudice rule met this requirement because the "rule is directed specifically at the insurance industry and is applicable only to insurance contracts." 134 F.3d at 945.

UNUM never contested this proposition in the court below.[9] Nevertheless, UNUM and its *amici* now argue that the notice-prejudice rule cannot be saved from preemption because it is "merely a common law rule of general application" which is not directed at the insurance industry. (Pet. Br. 23.) UNUM did not raise this argument in the Ninth Circuit nor in its petition for certiorari. Rather, as the Solicitor General notes, UNUM first presented this question about the notice-prejudice rule in its reply

[9] UNUM did not brief the application of the notice-prejudice rule in the Ninth Circuit. Rather, the sole issue in the case was whether MAC was UNUM's agent. UNUM's petition for rehearing and suggestion for rehearing en banc did not address the court's application of the notice-prejudice rule.

brief at the certiorari stage. U.S. Br. at 11. Therefore, it is a serious question whether this issue is properly before this Court and whether the belated insertion of this question by petitioner thwarts the proper functioning of this Court's certiorari process. *See Yee v. City of Escondido*, 503 U.S. 519, 533 (1992).

Assuming *arguendo* that this issue is "fairly included" in the questions presented in the petition, Sup.Ct.R. 14.1(a), petitioner's new argument is nevertheless wholly without merit. UNUM attempts to equate the California notice-prejudice rule with the Mississippi law of bad faith at issue in *Pilot Life*, but the comparison does not work in UNUM's favor. In *Pilot Life*, this Court traced the origins of plaintiff Dedeaux's claim for punitive damages for tortious breach of contract. Mississippi's Supreme Court had first recognized the availability of such relief in a 1915 contract action brought against a physician. *Pilot Life*, 481 U.S. at 49. Other early cases involved claims against a finance company for loss of cabled funds and against an individual for the destruction of a fence. *Id.* The generic doctrine allowing recovery of punitive damages was not applied against a defendant insurance company until 1977 — more than sixty years after the doctrine first arose. *Id.* Accordingly, this Court concluded in *Pilot Life* that the Mississippi doctrine of tortious breach was not "specifically directed toward th[e] [insurance] industry," but was generally applicable: "*Any* breach of contract, and not merely a breach of an insurance contract, may lead to liability for punitive damages under Mississippi law." 481 U.S. at 50 (emphasis added).[10]

[10] Indeed, even though employment of the doctrine in insurance litigation is now common, it is still expressed in generic terms applicable to any defendant in any industry, occupation, or other context. *See Pilot Life*, 481 U.S. at 48 (noting that plaintiff Dedeaux pleaded and described his own claim as a generic one for "tortious breach of contract" under "the Mississippi law of bad faith").

The same cannot be said about California's notice-prejudice rule. While UNUM and its *amici* are able to find California cases in which the English words "notice" and "prejudice" appear on the same page of the opinion, they cannot identify a single application of the notice-prejudice rule outside of the insurance context. (See cases cited at Pet. Br. 28; Brief *Amicus Curiae* of Cal. Ass'n. of Health & Life Insurers at 4-5.) Nor is respondent Ward — or for that matter, the Solicitor General — aware of any such case. (U.S. Br. at 12.) That is hardly surprising, given that the rule by its terms applies exclusively to "insurance companies" and concerns only prejudice to an "insurer" resulting from untimely notice from an "insured."[11]

UNUM and its *amici* offer a fictional bloodline for the notice-prejudice rule — a genealogy untainted by analysis of *any* of the California cases that actually developed the rule.[12] The relevant cases reveal a distinct and peculiar lineage for the notice-prejudice rule, which was formulated in decisions arising

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[11] *See, e.g., Shell Oil v. Winterthur Swiss Ins. Co.*, 12 Cal.App. 4th 715, 760 (1993) ("California law is settled that a defense based on an insured's failure to give timely notice requires the insurer to prove that it suffered substantial prejudice."); *Pacific Employer's Ins. Co. v. Superior Court*, 221 Cal.App.3d 1348, 1356, 270 Cal.Rptr. 779 (1990) ("California's notice-prejudice rule operates to bar insurance companies from disavowing coverage on the basis of lack of timely notice unless the insurance company can show actual prejudice from the delay.").

[12] UNUM claims that California's notice-prejudice rule is derived from two generally applicable common law doctrines: a duty of cooperation imposed on all parties to a contract, and a rule that prejudice must be shown before the failure to perform a contractual obligation or give a required notice will work a forfeiture. (Pet. Br. 27-28.) UNUM's amicus adds the theory that the notice-prejudice rule is merely a form of the general harmless error rule. Brief *Amicus Curiae* of Cal. Ass'n. of Health & Life Insurers at 5.

under several versions of a California statute that permitted an injured person who obtains a judgment against an insured person to bring an action against the insurer "on the policy" to satisfy the judgment.[13]

Far from being, as UNUM and its *amici* claim, merely a manifestation of general common-law principles about duties of cooperation by contracting parties, lack of prejudice, or harmless error, the original formulation of California's rule about notice in suits "on the policy" in fact rejected these principles and favored the insurance company by mandating strict enforcement of notice requirements as material terms of insurance contracts.[14]

The California Supreme Court spoke to the issue for the first time, albeit indirectly, in *Hynding v. Home Acc. Ins. Co.*, 214 Cal. 743, 7 P.2d 999 (1932). *Hynding* considered whether an insurer could assert its insured's failure to cooperate with it (by failing to attend the trial) as a defense in an action brought "on the policy" by the injured party against the insurer to satisfy a judgment against the insured. The court held that the insurer could indeed assert the insured's breach as a defense, provided that the insurer proved it was substantially prejudiced by the breach. 214 Cal. at 752, 7 P.2d at 1002. The only authorities cited by the court for this prejudice requirement were other

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[13] Cal. Stats. Of 1919, p. 776 (repealed), now Cal. Ins. Code § 11580, subd. (B)(2).

[14] The earliest California case Ward has been able to locate that addressed the effect of the insured's failure to comply with the notice provision in an insurance policy is *Aronson v. Frankfurt Acc. & Plate Glass Ins. Co.*, 9 Cal. App. 473, 99 P. 537 (1908), which held that the insured's failure to give timely notice barred coverage. *See also Los Angeles Athletic Club v. United States Fid. & Guar. Co.*, 41 Cal. App. 439, 183 P. 174 (1919) (court rejects plaintiff's claim that a minor breach of the policy should not bar coverage, holding instead that the condition requiring prompt notice was a material term of the contract).

insurance cases. *Id.* The notice-prejudice rule continued to develop thereafter as a distinctive regulation tailored to insurance policies.

Despite its statement regarding the need for the insurer to establish prejudice, *Hynding* did not change the law regarding a failure of notice. In 1935, the California Supreme Court held that an insured's failure to give timely notice prevented the insurer from conducting a prompt investigation of the claim and was presumed prejudicial. *Purefoy v. Pacific Auto. Indem. Exch.*, 5 Cal.2d 81, 53 P.2d 155 (1935). The lower courts read *Purefoy* to establish a conclusive presumption that the insured's failure to give timely notice was prejudicial.[15]

In *Abrams v. Am. Fid. & Cas. Co.*, 32 Cal.2d 233, 195 P.2d 797 (1948), the California Supreme Court cut back on *Purefoy* by holding that the insured could rebut the presumption with evidence that the insurer had not actually sustained prejudice. 32 Cal.2d at 238-239. Most cases thereafter held that the insured bore the burden of proving that the insurer had not sustained prejudice.[16]

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[15] *See, e.g., Distributors Packing Co. v. Pac. Indem. Co.*, 21 Cal. App. 2d 205, 70 P.2d 253 (1937); *Margellini v. Pacific Auto. Ins. Co.* 33 Cal.App.2d 93, 91 P.2d 136 (1939); *Burbank v. Nat. Cas. Co.*, 43 Cal.App.2d 773, 111 P.2d 740 (1941); *Brown Materials Co., LTD v. Pac. Auto. Ins. Co.*, 52 Cal.App.2d 760, 127 P.2d 51 (1942); *Arthur v. London Guar. & Acc. Co.*, 78 Cal. App.2d 198, 177 P.2d 625 (1947).

[16] *See, e.g., Reed v. Pac. Indem. Co.*, 101 Cal.App.2d 151, 225 P.2d 255 (1951)(burden on insured); *Artukovich v. St. Paul-Mercury Indem. Co., Inc.*, 150 Cal.App.2d 312, 310 P.2d 461 (1957)(same); *Security Ins. Co. v. Snyder-Lynch Motors, Inc.*, 183 Cal.App. 2d 574, 7 Cal.Rptr. 28 (1960)(same). *But see Joyce v. United Ins. Co. of America.*, 202 Cal.App.2d 654, 21 Cal.Rptr. 361 (1962)(untimely notice did not defeat claim where insurer failed to produce evidence of prejudice).

California's notice-prejudice rule finally took its present form (but not yet its familiar name) in 1963 in *Campbell v. Allstate Ins. Co.*, 60 Cal.2d 303, 32 Cal.Rptr. 827 (1963). *Campbell*, like *Hynding* and *Abrams*, was an action against the insurer to satisfy a judgment against its insured. It reaffirmed the requirement imposed by *Hynding* that the insurer could not assert its insured's breach of a condition imposed by the policy as a defense unless it demonstrated that the breach caused it to sustain substantial prejudice. 60 Cal.2d at 305-306. The court also held that the insurer bore the burden of proving it had sustained prejudice, and that prejudice could no longer be presumed. *Id.* at 306-307.[17]

The term "notice-prejudice rule" was first used in a depublished California decision in 1988,[18] and the first published decision to use the term was *Industrial Indem. v. Superior Court*, 224 Cal.App.3d 828, 275 Cal.Rptr. 218 (1990), which refused to apply the rule to a "claims made" insurance policy. The majority position among the California courts is that the rule is only applicable to "occurrence"-type policies, and not to so-called "claims-made" policies.[19] Thus, far from being a generally

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[17] The rule was refined in *Billington v. Interins. Exch. Of So. Cal.*, 71 Cal.2d 728, 79 Cal.Rptr. 326 (1969), where the court held that, in order for an insurer to prove it has been prejudiced by the insured's lack of cooperation, it must establish that if the clause had not been breached there was a substantial likelihood that the trier of fact in the underlying suit against the insured would have found in the insured's favor.

[18] *Village Escrow Co., Inc. v. Nat. Union Fire Ins. Co.*, 248 Cal.Rptr. 687 (1988), review denied and ordered withdrawn from publication in the Official Reports, Oct. 13, 1988.

[19] There is a split of authority in California regarding the application of the rule to "claims-made-and-reported" types of policies, as opposed to "occurrence" policies. Compare *Pacific Employer's Ins. Co. v. Superior Court*, 221 Cal.App.3d at 1358-1361

applicable common-law rule like Mississippi's punitive damages doctrine, the notice-prejudice rule is not even universally applied within its own constricted field of insurance regulation.

There is one further important difference between this case and *Pilot Life*. This Court found the connection between Mississippi's punitive damages rules and "the insurer-insured relationship" to be "attenuated at best." 481 U.S. at 50-51. That common law doctrine "does not define the terms of the relationship between the insurer and the insured; it declares only that, whatever terms have been agreed upon," a breach of that contract "may in certain circumstances allow the policyholder to obtain punitive damages." *Id.* at 51. In contrast, California's notice-prejudice rule, as demonstrated above, overrides an insurance contract's deadlines and thereby alters the policy's terms and rearranges the rights of insurer and insured under the contract.

This history of the California notice-prejudice rule demonstrates that UNUM's claim that the rule is a generally applicable common-law contract rule is a sham. The contrast between this case and the Mississippi law of tortious breach of contract at issue in *Pilot Life* could not be more stark. The notice-prejudice rule has, from its origins 90 years ago, always been a regulation of insurance contracts *only*, and originally it was the very opposite of a "harmless error" or "no prejudice" rule. But even were we to posit *arguendo* that the contemporary

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(holding that the notice-prejudice rule does not apply to "claims-made" policies) and *Slater v. Lawyer's Mut. Ins. Co.*, 227 Cal.App.3d 1415, 1422-1424, 278 Cal.Rptr. 479 (1991)(same); with *Northwestern Title Security Co. v. Flack*, 6 Cal.App.3d 134, 143-144, 85 Cal.Rptr. 693 (Cal. App. 1970) (rejecting distinction for purposes of operation of the rule). The policy at issue here is not a "claims-made" policy, and UNUM has not argued in this Court or below that the notice-prejudice rule should not apply here for any reason other than ERISA preemption.

version of the rule, which no longer presumes prejudice and now puts the burden of proving prejudice on the insurer, could be seen as resonating with harmless error rules found elsewhere in the common law, the result in this case would not change.

Pilot Life remarked that the "roots" of the Mississippi doctrine of bad faith were "firmly planted in the general principles of Mississippi tort and contract law." 481 U.S. at 50. UNUM seeks to extrapolate from this a broad principle that no common law rule, even one directed exclusively at the insurance industry, can qualify as an insurance regulation under the saving clause unless it is truly *sui generis*. But petitioner reads far too much into the Court's turn of phrase, which merely pointed out the general applicability of the Mississippi doctrine.

Surely a state law specifically directed at insurance does not lose its protected status under the ERISA saving clause simply because its animating principles might be similar to the principles underlying other rules found elsewhere in the expansive corpus of the common law. The law is, after all, a seamless web, and its various principles enrich and inform each other as the law evolves. It would be bizarre if the principles underlying one body of law, such as insurance regulation, were in fact wholly unique and entirely unrelated to any other rules anywhere else in the common law — as if the law's categories had separated like the Earth's continents long ago, leaving insurance regulation as some quirky collection of evolutionary oddities and dead-ends, the legal equivalent of Australia's duckbilled platypus and marsupials. Yet that is the understanding of the common law that UNUM asks this Court to embrace.

UNUM's approach is simply an ill-disguised attempt to read into the saving clause restrictions that Congress did not include. This argument proves too much, for under it even recognized forms of state insurance regulation, such as laws forbidding false and deceptive insurance sales practices, would

be considered mere manifestations of the generally applicable common law tort rules of fraud, and would therefore be preempted. Yet in *FTC v. Nat'l Casualty Co.*, 357 U.S. 560, 562 & n. 2 (1958), this Court held that state laws prohibiting false, misleading and deceptive insurance sales practices were indeed laws "regulating the business of insurance." UNUM's radically reductive approach would empty the saving clause of meaning and convert ERISA into a juggernaut of destruction of state insurance regulations that Congress manifestly intended to preserve.

B. The McCarran-Ferguson Act Factors Confirm That The California Notice-Prejudice Rule Is Insurance Regulation That Is Saved From Preemption.

In *Metropolitan Life* this Court found that its "common-sense" determination of whether a state law regulated insurance for purposes of the ERISA saving clause was supported by "the traditional understanding of insurance regulation." 471 U.S. at 744. That understanding is to be found by reference to cases interpreting the scope of the McCarran-Ferguson Act — in particular, by reference to the three factors summarized in *Pireno*, 458 U.S. at 129. *See* page 5, *supra*.

But while often illuminating, consideration of these factors has not been held by this Court to be an essential part of its analysis under the ERISA saving clause if the common sense inquiry is sufficient to render an answer. Thus in *FMC Corp. v. Holliday*, 498 U.S. 52 (1990), which contains this Court's most recent discussion of the saving clause, the Court did not even discuss the McCarran-Ferguson Act factors in concluding that Pennsylvania's anti-subrogation law regulated insurance. Instead, the Court relied exclusively on the common sense analysis set forth in *Metropolitan Life*: Does it regulate insurance contracts, and is it directed only at the insurance industry?

> There is no dispute that the Pennsylvania law falls within ERISA's insurance savings clause. . . . Section 1720 directly controls the terms of insurance contracts by invalidating any subrogation provisions they contain. It does not merely have an impact on the insurance industry; it is aimed at it.

498 U.S. at 60-61.[20]

That same common-sense analysis is more than sufficient to decide this case without separate consideration of the McCarran-Ferguson Act factors, because the Court's conclusions in *FMC* apply with equal force to California's notice-prejudice rule. As demonstrated above, (1) the rule regulates the relationship between insurer and insured by overriding any policy terms that permit denial of benefits for non-prejudicial lapses in timely notice; and (2) the rule applies exclusively to insurance contracts and the insurance industry.

In any event, consideration of the McCarran-Ferguson factors only confirms this conclusion. In *Cisneros* the court of appeals held that the notice-prejudice rule easily met two of the McCarran-Ferguson factors, which overlap with the common-sense test discussed above. Specifically, the court of appeals held that the rule regulates "an integral part of the policy relationship between the insurer and the insured" and that it is "limited to entities within the insurance industry." 134 F.3d at 946. Those conclusions are sound and not subject to serious

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[20] The portion of the *Metropolitan Life* opinion cited by the Court in *FMC*, 471 U.S. at 740-41, discussed the common-sense view that the statute regulated insurance because it regulated the content of insurance contracts, and the way in which ERISA's "deemer clause" reinforced that conclusion. *FMC* neither referred to nor relied upon the portion of the *Metropolitan Life* opinion that discussed the McCarran-Ferguson Act factors.

question. The only real dispute is over the remaining McCarran-Ferguson Act factor: whether the notice-prejudice rule "has the effect of transferring or spreading a policy-holder's risk." *Metropolitan Life*, 471 U.S. at 743.

1. The notice-prejudice rule can be understood as spreading risk within the meaning of the first McCarran-Ferguson Act factor.

In *Cisneros* the Ninth Circuit concluded that, although the notice-prejudice rule "does shift the risk of lost coverage as a result of late submission of proof," it does not "alter the allocation of risk for which the parties initially contracted" — that is, the risk of disability. 134 F.3d at 946. It therefore held that the rule does not satisfy the McCarran-Ferguson "risk spreading" criterion, which it believed refers only to the specific risk of injury for which the insurer agreed in the policy to compensate the insured. *Id.* at 945-46. As the Solicitor General points out, the line the court of appeals tried to draw is not without support in the decisions of the lower federal courts, but in the final analysis it is unsatisfactory. U.S. Br. at 13-14 & n.6.

In particular, this purported distinction between different risks is in tension with this Court's decision in *United States Dept. of the Treasury v. Fabe*, 508 U.S. 491 (1993). *Fabe* demonstrates that a law can be deemed to spread risk if it is directed to ensuring that the insurance contract will be performed and that benefits will be provided, even if that law does not itself address the question of benefits or the terms of coverage under the policy. *Fabe* held that an Ohio statute establishing the priority of creditor claims against insurance companies in liquidation regulated the "business of insurance" to the extent that it operated to protect policyholders by giving them a preference. The Court rejected the argument that the statute did not spread risk, because without that preference the insurance policies would never be performed, no benefits would be paid, and hence the contracted-for risk would never be spread:

> There can be no doubt that the actual performance of an insurance contract falls within the "business of insurance" as we understood that phrase in *Pireno* . . . . Without performance of the terms of an insurance policy, there is no risk transfer at all.

508 U.S. at 503-504.

The notice-prejudice rule operates in much the same way the Ohio statute did in *Fabe*, and under its approach can be said to spread risk. Neither law increases an insured's coverage, but both operate to ensure the policy will be performed to the insured's benefit in circumstances where, in the absence of the rule or preference, there would be no performance and hence no risk-spreading.

Furthermore, as the Solicitor General points out, "insofar as the notice-prejudice rule shifts the risk of late notice and stale evidence from the insured to the insurance company in some instances, it has the effect of raising premiums and spreading risk among policyholders." U.S. Br. at 14. Indeed, UNUM itself has taken this same position on risk-spreading. In *Cisneros*, UNUM argued that the Pennsylvania anti-subrogation statute at issue in *FMC v. Holliday* did, in fact, spread risk, because it would have forced benefit providers "to calculate benefit levels differently" as a result of their inability to recoup the costs of benefit payments made to participants and beneficiaries. (Reply Br. of Petitioner UNUM to Brief In Opposition in No. 97-1867 at 6 n.4). "As such, the law would clearly impact 'the risks of injury that the insurance company will bear for the insured.'" (*Id.*) (citation omitted). UNUM's argument is that the statute raised the benefit providers' costs, which would ultimately either be passed on in the form of higher premiums or be offset by lower benefit levels. That is the same argument made by the Solicitor General with respect to the notice-prejudice rule. Ward concurs with the Solicitor General and with UNUM on this point.

The Court need not resolve in this case any tension that may exist between the discussion of risk spreading in *Pireno* and its decisions in *Fabe* and *FMC*, because there simply is no requirement that a state law spread risk in order to be characterized as "regulating insurance" under the saving clause.

2. A state law may "regulate insurance" within the meaning of the ERISA saving clause even if it does not spread the particular kind of risk addressed by the McCarran-Ferguson Act factor.

This Court has observed that risk-spreading, one of the McCarran-Ferguson factors, is an "indispensable" element of an insurance contract. *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205, 211-12 (1979). From this unremarkable proposition UNUM concocts the remarkable non-sequitur that no law qualifies as a regulation of insurance *unless* it directly spreads risk itself. (Pet. Br. 10, 23-26.) UNUM contends that no state law is saved from preemption under ERISA unless it meets *all three* of the McCarran-Ferguson Act factors and, in particular, that "the failure to spread risk, by itself, places the notice-prejudice rule far outside the saving clause." (Pet. Br. 23.)[21]

Not so. Ever since this Court first enumerated those three factors it has consistently disavowed any use of them as a

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[21] In making this argument that a state law that does not spread risk cannot regulate insurance, the insurance industry has turned 180 degrees from its position in *Metropolitan Life*. There, it argued that a mandated-benefit law, the epitome of a risk-spreading law, did not regulate insurance. Brief *Amicus Curiae* of the American Council of Health Insurers in No. 84-325, at 19, 20; Brief of Appellant Metropolitan Life Ins. Co. in No. 84-325, at 35-37. Now it argues that *unless* a law is a mandated benefit law, it cannot be said to regulate insurance.

mandatory three-part test, either under the McCarran-Ferguson Act itself or with respect to ERISA preemption. In *Pireno* this Court explicitly cautioned that "[n]one of these criteria is necessarily determinative in itself." 458 U.S. at 129. UNUM dismisses this statement as "ambiguous dictum" (Pet. Br. 24), but there is nothing ambiguous about it and the Court's use of the factors after *Pireno* has been fully consistent with this statement. In *Pilot Life* the Court referred to the three factors as "guide[s] and "considerations [to be] weighed." 481 U.S. at 48.[22] In *Metropolitan Life*, where the factors were first applied to illuminate the ERISA saving clause, the Court described them not as three independent *sine qua nons* of insurance regulation, but merely as "three criteria relevant to determining whether a particular practice falls within . . . the 'business of insurance.'" 471 U.S. at 743. The Ninth Circuit was therefore entirely consistent with this Court's own approach when it held that the McCarran-Ferguson factors "are simply relevant considerations or guideposts, not separate essential elements of a three-part test that must be satisfied for a law to escape preemption." *Cisneros*, 134 F.3d at 946.[23]

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[22] In *Pilot Life*, on which UNUM places great weight, if the failure to spread risk had indeed been dispositive in and of itself, there would have been no need for the Court to address the other two factors once the Court had determined that the law in question did not spread risk. 481 U.S. at 50. Yet the Court did so. *Id.* at 50-51.

[23] Two other circuits have likewise adhered to this Court's approach. *See O'Connor v. UNUM Life Ins. Co.*, 146 F.3d 959, 963 (D.C. Cir. 1998) ("none of the factors in the test is by itself determinative of what constitutes the business of insurance"); *Davies v. Centennial Life Ins. Co.*, 128 F.3d 934, 940 (6th Cir. 1997) ("These criteria must be considered in combination, and, standing alone, no single one is dispositive."). The only court to have taken the rigid approach urged by UNUM is the Fifth Circuit. *See CIGNA Healthplan v. Louisiana*, 82 F.3d 642, 650 (5th Cir.) ("if a statute fails . . . to satisfy any one element of the . . . test, then the statute is not exempt from preemption"), *cert. denied*, 519 U.S. 964 (1996).

Even on its own terms, UNUM's crabbed definition of the regulation of insurance makes no sense. To accept that risk-spreading is an "indispensable characteristic of insurance," *Royal Drug*, 440 U.S. at 211-12, is not to say that it is the *only* characteristic of insurance. While the business of insurance may be, as a commercial matter from the insurance company's perspective, basically the spreading of risks, there is no reason that a law regulating the insurance business must spread risk. This Court has accordingly recognized that the "broad category of laws enacted 'for the purpose of *regulating* the business of insurance' . . . necessarily encompasses more than just the 'business of insurance.'" *Fabe*, 508 U.S. at 505 (emphasis added).

For example, state laws "aimed at protecting or regulating" the relationship between the insurance company and the insured, whether "directly or indirectly, are laws regulating the 'business of insurance.'" *SEC v. National Securities*, 393 U.S. at 460.[24] In *Metropolitan Life*, this Court included in its description of the many facets of state insurance regulation several types of laws that do not spread risk in the way UNUM uses the term. These included laws "governing solvency or the qualification of management" [of insurers], laws regulating "claims practices or rates," and laws requiring insurance policies to provide grace periods and conversion privileges. 471 U.S. at 728 n.2. Furthermore, this Court held in *Federal Trade Commission v. Nat. Cas. Co.*, 357 U.S. at 564, that a state law that regulated deceptive insurance advertising qualified as a state law "enacted for the purpose of regulating the business of insurance" under the McCarran-Ferguson Act.

All of these laws would be preempted under UNUM's unduly narrow definition of insurance regulation. UNUM, however, realizing that its argument is without support in logic

[24] California's notice-prejudice rule falls into this category, as demonstrated above.

or precedent, ultimately concedes the point at pages 25-26 of its brief, where it acknowledges that many state laws that do not spread risk have nonetheless been held to "regulate insurance," including laws that govern the "selling and advertising of policies and the licencing of insurers and their agents."[25]

[25] Oddly, two of UNUM's *amici* here, the American Council of Life Insurers and the Health Insurance Industry of America, who in this case endorse UNUM's limited view of what constitutes insurance regulation, have advanced an incompatible view in another case argued this term, *Forsythe v. Humana*, No. 97-303. In their amicus brief filed in that case, these insurance industry trade associations urged the Court to construe the McCarran-Ferguson Act to preserve the "carefully constructed system of individual state regulation designed to protect insurance policyholders not only from misleading insurer misconduct, but also from, among other things, risks to the solidity of insurers and to an adequate and healthy insurance market." Brief of American Council of Life Insurers, 1998 WL 457677*4. Yet, state insurance regulations of this type do not spread risk. In fact, the very Nevada statute at issue in *Forsythe*, which prescribes the penalties available to a party defrauded by an insurer, does not spread risk. If the test proposed by UNUM and its *amici* here were applied in *Forsythe*, it would wholly undercut the argument of petitioner Humana, on behalf of itself and the entire insurance industry, that RICO cannot be applied to insurers without "impairing" the Nevada statute and similar laws in other states. Another insurance industry *amicus* in *Forsythe*, the Consumer Credit Insurance Assoc. of America, helpfully compiled in its brief a 50-state survey of state laws that it said regulate insurance, but that would be invalidated or impaired if the Court affirmed the judgment against petitioner Humana in *Forsythe*. Most of those laws do not spread risk, and therefore would not qualify as "state laws enacted for the purpose of regulating the business of insurance" under the test proposed by UNUM and its *amici* here.

C. The Notice-Prejudice Rule Does Not Conflict With Any Aspect of ERISA or Any Other Federal Law.

UNUM contends that, even if the notice-prejudice rule falls within the saving clause, it is nevertheless preempted because it conflicts with various parts of ERISA, the ERISA regulations promulgated by the Department of Labor, and the McCarran-Ferguson Act. UNUM's argument is wrong on all counts.

UNUM first argues that the rule conflicts with ERISA's exclusive civil enforcement remedies because it "furnish[es] a state remedy under which benefits are not 'confined to the terms of the plan as written.'" (Pet. Br. 33.) This argument is grounded on the mistaken premise that a claim that conflicts with the terms of a plan cannot be a claim for benefits under ERISA, 29 U.S.C. § 1132(a), and therefore instead must be a forbidden state cause of action for failure to pay benefits. (Pet. Br. 9, 16, 32-33.) *Metropolitan Life* teaches otherwise. There, the Court sustained the enforcement of a statute requiring insurance policies to provide mental health benefits, *even though the policy itself did not provide the required benefits*. 471 U.S. at 734.[26] Similarly, *FMC Corp.* allowed the application of a state law forbidding subrogation claims even if the policy in question expressly provided for subrogation. 498 U.S. at 60-62.

It simply makes no sense to argue, as UNUM does, that although ERISA permits a state to alter the terms of an insurance contract to provide certain benefits, ERISA nevertheless forbids

[26] *Metropolitan Life* provided another example of a state insurance regulation that would not be preempted by ERISA even when it altered contract terms: a law that would "require that coverage for dependents *continue beyond any contractually imposed age limitation* when the dependent is incapable of self-sustaining employment because of mental or physical handicap." 471 U.S. at 729 (emphasis added).

the policyholder from seeking benefits under the altered policy. Ward's complaint expressly (and exclusively) invoked 29 U.S.C. § 1132 and sought only the recovery of benefits pursuant to ERISA. Pet. App. 77a-80a. The fact that state law, as ERISA permits, changed the terms of UNUM's policy to expand the benefits provided does not mean that the law created a new remedy.[27]

UNUM next contends (Pet. Br. 34-35) that the notice-prejudice rule conflicts with the rules for claims processing set forth in Section 503 of ERISA, 29 U.S.C. §1133, and with the regulations promulgated by the Department of Labor under that section, 29 C.F.R. § 2560.503-1(b), (c) & (d). (Pet. App. 105a-107a). There is no conflict. The notice-prejudice rule defines the circumstances when a claim can be denied based on late notice by the insured. The statutory provision UNUM cites, Section 503, deals with the claimant's rights *after* a claim has been denied. The regulations UNUM points to specify the minimum requirements for a reasonable claims procedure that all plans must meet. 29 C.F.R. § 2560.503-1(a). None of these provisions addresses *when* notice must be given. The United States itself perceives no conflict between these provisions and the notice-prejudice rule. U.S. Br. at 19 n.9.

Finally, UNUM complains that applying the notice-prejudice rule to insurance contracts bought by ERISA plans, but not to self-funded plans exempted by ERISA's "deemer clause,"

[27] In a similar vein, UNUM argues that application of the notice-prejudice rule, contrary to a plan's express establishment of notice deadlines, conflicts with the ERISA requirement that plan fiduciaries follow the written terms of the plan and pay benefits only in accord with those terms. (Pet. Br. 9, 14, 32-33.) *See* 29 U.S.C. §§1104(a)(1)(D), 1132(a)(1)(B). This argument is frivolous. Those ERISA provisions cannot be read to require fiduciaries to follow a plan's terms in contravention of applicable state or federal law that imposes different obligations.

would subvert an alleged congressional program of "'nationally uniform administration' of all plans, self-funded and insured alike." Pet Br. 9. *See id.* at 14-15, 21. This argument was unanimously rejected by the Court more than a decade ago:

> We are aware that our decision results in a distinction between insured and uninsured plans, leaving the former open to indirect regulation while the latter are not. By so doing we merely give life to a distinction created by Congress in the "deemer clause," a distinction Congress is aware of and one it has chosen not to alter.

Metropolitan Life, 471 U.S. at 747. *See also FMC Corp.*, 498 U.S. at 64 ("Our interpretation of the deemer clause makes clear that if a plan is insured, a State may regulate it indirectly through regulation of its insurer and its insurer's insurance contracts; if the plan is uninsured, the State may not regulate it.").[28]

Undeterred, UNUM takes its "disuniformity" harangue to the next level, arguing that, if state laws like the notice-prejudice rule are saved from ERISA preemption, "[c]haos" is "certain to follow, with plan administration for interstate employers once again becoming a Byzantine maze" of conflicting regulations. (Pet. Br. 12; 31, 46-49.) This argument was also unanimously rejected in *Metropolitan Life*:

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[28] Petitioner argues that the deemer clause would bar application of the notice-prejudice rule in cases where a self-funded plan hired an insurance company not to insure, but only to administer, the plan. (Pet. Br. 36-37.) Perhaps so, but the plan at issue here, MAC's plan, is an insured plan and UNUM is the plan insurer. The deemer clause therefore has no direct application in this case, although its existence in ERISA does buttress Ward's reading of the saving clause, as explained in Part I.A. above.

> We also are aware that [a different] construction of [ERISA] would eliminate some of the disuniformities currently facing national plans that enter into local markets to purchase insurance. Such disuniformities, however, are the inevitable result of the congressional decision to "save" local insurance regulation. Arguments as to the wisdom of these policy choices must be directed at Congress.

471 U.S. at 747.

Refusing to take Congress (and this Court) at its word, UNUM perseveres, protesting that this "dysfunction" cannot be viewed simply as an inevitable result of Congress' desire to save state insurance regulation. (Pet. Br. 31.) UNUM reasons that, since Congress knew that 80% of employee benefit plans are insured, if it really had intended to exempt state insurance regulations such as the notice-prejudice rule from preemption, and had thereby intended to allow these legions of insured plans to be subjected to non-uniform state regulation, Congress would have belabored this fact in ERISA's 15-volume legislative history. (Pet. Br. 18-19.) UNUM claims that "Congress simply could not have intended such a dramatic exception to its regulatory scheme without some affirmative indication to that effect." (Pet. Br. 19.)

Of course, the "affirmative indication" that UNUM seeks is to be found, as this Court has repeatedly held, in the *text* of the saving and deemer clauses. UNUM's proposal that the Court rewrite ERISA's text not on the basis of what Congress said about these clauses in the legislative history, but on the basis of "Congress' *silence* on this subject," (Pet. Br. 19, emphasis added), is a perilous approach to statutory construction that would subvert the proper constitutional relationship between the legislature and the judiciary. This Court should not entertain

UNUM's "speculative attempt to read the saving clause out of the statute." *Metropolitan Life*, 471 U.S. at 747.[29]

II. ERISA DOES NOT PREEMPT CALIFORNIA'S GENERAL LAWS OF AGENCY BECAUSE THOSE LAWS DO NOT "RELATE TO" ERISA PLANS WHEN APPLIED TO THE RELATIONSHIP BETWEEN AN INSURER AND ITS AGENTS.

A. The Ninth Circuit Decided This Case Based On The Application Of General Agency Law, *Not* The *Elfstrom* Rule.

Although the *Elfstrom* decision, which pre-dated ERISA's enactment, does not expressly refer to "ERISA plans,"

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[29] UNUM's final point is both confused and confusing. (Pet. Br. 37-38.) Petitioner appears to argue that because ERISA "specifically relates" to insurance, the clause in § 2(b) of the McCarran-Ferguson Act that prevents state laws that regulate insurance from being "impaired, invalidated or superceded" by federal legislation (such as ERISA) unless that legislation "specifically relates" to insurance, 15 U.S.C. §1012(b), has no application in this case. UNUM thus appears to be arguing that, under the McCarran-Ferguson Act, ERISA "specifically relates" to insurance and therefore governs this case. Ward is unsure what this is supposed to add to the debate, since he agrees that ERISA controls here and that its Section 514(a) would preempt the notice-prejudice rule in the absence of the saving clause. Of course, the saving clause in Section 514(b)(2)(A) does preserve the rule as a state regulation of insurance. The only other possible interpretation of this puzzling argument is that UNUM is saying that, even if ERISA itself saves the notice-prejudice rule, some contorted combination of ERISA and the McCarran-Ferguson Act somehow preempts the rule nevertheless — and that makes no sense at all.

the group insurance plans the rule targets would appear to be ERISA welfare plans under 29 U.S.C. § 1002(1). *See District of Columbia v. Greater Washington Board of Trade*, 506 U.S. 125, 130 (1992). Respondent therefore assumes arguendo that the California Supreme Court's *Elfstrom* rule "relates to" ERISA plans because it makes reference to ERISA plans and is premised on the existence of a plan. *See Ingersoll- Rand Co. v. McClendon*, 498 U.S. 133, 140 (1990).

But this does not end the preemption inquiry because the court below did not actually apply the *Elfstrom* rule in this case. Instead, the court of appeals reformulated the rule, from one holding that employers who administer insured plans are agents of the insurer *as a matter of law*, to one based on a *factual inquiry* about the employer's status under general principles of agency law. The clearest indication of this decisive departure from *Elfstrom* is the court's disposition of this case — the court remanded for a factual inquiry into whether MAC was UNUM's agent, whereas under *Elfstrom* that question would have been resolved as a matter of law and there would have been no need for a remand.

The court also demonstrated that it was not applying *Elfstrom* literally when it endorsed the "formulation" of the *Elfstrom* rule suggested in *Paulson v. Western Life Ins. Co.*, 636 P.2d 935 (Or. 1981) (Pet. App. 12a, 13a n.6). In *Paulson*, the Oregon Supreme Court reconciled the split between cases like *Elfstrom*, which held that an employer which administered a group insurance plan was the insurer's agent as a matter of law, with cases from other jurisdictions reaching a contrary conclusion. The Oregon court explained that the differing outcomes were the result of variations in the role the employer

actually undertook, and that in most cases the employer's status as an agent presented a question of fact. (Pet. App. 13a, n.6.)[30]

The fact that the court below did not actually apply the *Elfstrom* doctrine largely disposes of petitioner's argument for preemption under ERISA, because UNUM predicates its argument almost exclusively on whether the specific *Elfstrom* rule as such, rather than the common law of agency in general, makes reference to and is premised upon the existence of, and hence "relates to," ERISA plans. (*See* Pet. Br. 41.)[31]

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[30] The court of appeals' application of general agency principles was also evident in the court's rejection of UNUM's claim that the literal terms of its policy trumped California agency law. The court stated, "Ostensibly, the legislative effort was to ensure that employee benefits are provided through an ERISA plan overseen by plan fiduciaries, including the plan insurer and those who the insurer may enlist to participate in the administration of the plan. Nothing in § 514(a) empowers a plan fiduciary to extend ERISA's preemptive reach by using policy language that negates agency law principles in favor of exonerating itself from the errors of those who act on its behalf." (Pet. App. 22a.)

[31] UNUM cites *Jass v. Prudential Health Care Plan*, 88 F.3d 1482, 1488-89 (7th Cir. 1996), for the proposition that "ERISA preempts agency rules" because they have "'the effect of regulating the structure or administration of ERISA plans.'" (Pet. Br. 41) (purporting to quote from the *Jass* opinion). But no such language or point appears on the cited pages. Instead, *Jass* holds that a state law tort claim against a plan officer for refusing to authorize payment for medical treatment is preempted by ERISA's exclusive remedy provisions. 88 F.3d at 1488-89. That holding, while correct, has no bearing on this case because, as explained above, Ward has not sought to circumvent ERISA by bringing a state-law cause of action. Rather, unlike the plaintiff in *Jass*, he has sought only plan benefits under ERISA.

B. General Agency Law Principles Do Not Refer To Or Have A Connection With ERISA Plans.

Section 514(a) of ERISA states that the statute preempts state law insofar as it "relates to" ERISA plans. In this Court's "earlier preemption cases, it had not been necessary to rely on the expansive character of ERISA's literal language in order to find preemption," because the state laws at issue there "had a clear 'connection with or reference to' ERISA benefit plans." *De Buono v. NYSA-ILA Medical And Clinical Services Fund*, 520 U.S. 806, 117 S.Ct. 1747, 1751 (1997).

Clearly, California's rules of agency, including the rule that permits notice to an agent to be imputed to the principal in some circumstances, do not refer to ERISA plans — nor does UNUM contend otherwise. Those rules apply generally to any person or entity that chooses to arrange its relationships in a fashion that brings the agency rules into play. The rules do not single out employee benefit plans, nor do they require the existence of a plan to operate. California's agency rules therefore do not "make 'reference to' ERISA plans in any manner." *Travelers*, 514 U.S. at 656 (observing that New York's surcharges on patients and HMOs do not "refer to" ERISA plans).

It is a far more difficult question whether application of agency principles, in the manner they might be applied here on remand, could nevertheless be said to "relate to" a plan sufficiently to result in preemption. And, of course, it is not a question that the Court needs to reach to resolve this case, because the judgment below can be affirmed solely upon an application of the notice-prejudice rule. *See* Part I above.

The difficulty in deciding whether general agency rules "relate to" ERISA plans lies in the fact that this Court's most recent decisions have flatly rejected "an expansive and literal interpretation of the words 'relate to' in §514(a) of ERISA." *De Buono*,117 S.Ct. at 1751. That "text could not be read to 'extend to the furthest stretch of its indeterminacy, [or] for all practical purposes preemption would never run its course.'" *Id.* (quoting *Travelers*, 514 U.S. at 655). Accordingly, the Court has "unequivocally concluded" that ERISA did not "modify 'the starting presumption that Congress does not intend to supplant state law.'" *De Buono*, 117 S.Ct. at 1752 (quoting *Travelers*, 514 U.S. at 654).

In *Travelers*, *De Buono* and *Cal. Div. Of Labor Enforcement v. Dillingham Construction Co.*, 117 S.Ct. 832 (1997), the Court held that state laws that indirectly affected the choices available to ERISA plans in the marketplace did not "relate to" ERISA plans. In *Dillingham*, the Court held that a California prevailing wage law does not "relate to" ERISA plans because it merely "alters the incentives, but does not dictate the choices, facing ERISA plans." 117 S.Ct. at 842. The law did not require ERISA plans to do anything — it merely created incentives to use apprentices participating in state-approved programs because those apprentices could be paid a lower wage than apprentices from non-approved programs. *Id.* at 841. The Court concluded that it "could not hold preempted a state law in an area of traditional state regulation based on so tenuous a relation without doing grave violence to our presumption that Congress intended nothing of the sort." *Dillingham*, 117 S.Ct. at 842.

Similarly, *Travelers* held that a state law imposing higher surcharges on hospital rates for patients insured by commercial insurers than those insured by Blue Cross/Blue Shield did not "relate to" ERISA plans, even though it raised the cost of

commercial insurance policies purchased by ERISA plans. 514 U.S. at 662. The Court found that this sort of indirect influence on plans — which might provide an incentive for a plan to favor one arrangement over another, but which did not "force" plans "to adopt a certain scheme of substantive coverage" or "restrict [their] choice of insurers" — did not have a sufficient connection with ERISA plans to trigger preemption. 514 U.S. at 668.

Most recently, in *De Buono*, the Court held that a state tax on the gross receipts of hospitals, including hospitals owned and operated by ERISA plans, did not "relate to" ERISA plans. 117 S.Ct. at 1752. The plans were left with the choice of how to arrange to provide health care benefits for their members, with one option being ownership of a hospital subject to the state's tax. Therefore, that state tax law was merely "one of 'myriad state laws' of general applicability that impose some burdens on the administration of ERISA plans but nevertheless do not 'relate to' them within the meaning of the governing statute." 117 S.Ct. at 1752.

Here, as in *De Buono*, *Travelers* and *Dillingham*, California's agency rules do not bind ERISA plans to any particular choice. Agency rules simply function in a way that makes certain choices have certain consequences. That is, *if* an insurer *chooses* to involve an employer or other entity in administering its insurance policy, that entity may under some fact patterns be deemed an agent, and notice to the agent may then be imputed to the principal.[32] The choice to involve MAC

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[32] California Civil Code § 2332 governs the imputation of notice. It provides, "As against a principal, both principal and agent are deemed to have notice of whatever either has notice of, and ought, in good faith and the exercise of ordinary care and diligence, to communicate to the other."

in administering its policy was entirely UNUM's. Granted, California's agency rules may have some effect on UNUM's choices in plan administration, but many state laws of general application "will have some effect on the administration of ERISA plans, [and] that simply cannot mean that every state law with such an effect is preempted by the federal statute." *De Buono*, 117 S.Ct. at 1753. ERISA does not preempt state laws that have only a "'tenuous, remote or peripheral' connection with covered plans . . . as is the case with many laws of general applicability." *Greater Washington Board of Trade*, 506 U.S., at 130 n. 1. As in *De Buono*, Travelers, and *Dillingham*, in this case any effect on the plan from application of state agency law principles is indirect and incidental.

Contrary to UNUM's apparent position, ERISA does not generally forbid the application of state law principles. "ERISA leaves room for complimentary or dual federal and state regulation, and calls for federal supremacy when the two regimes cannot be harmonized or accommodated." *John Hancock Mut. Life Ins. Co. v. Harris Trust & Savings Bank*, 510 U.S. 86, 98 (1993). Here, there is no direct conflict between ERISA and the background principles of agency law because ERISA is silent on the issue of agency.[33]

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[33] Although the United States argues that the *Elfstrom* rule itself is preempted (U.S. Br. 26), it does not argue that general agency principles are at odds with anything in ERISA. Indeed, in suggesting that the *Elfstrom* rule might properly be adopted as a matter of federal common law under ERISA (*id.* at 28), the United States makes clear that the rule in no way conflicts with any aspect of the statute. If the Court were to hold that ERISA preempts the application of California agency principles here, Ward would concur in the suggestion of the Solicitor General that, on remand, the courts below should consider whether the agency principles relied upon by the Ninth Circuit should apply to the circumstances of this case as a matter of federal common law.

This case does, of course, differ from *De Buono*, *Travelers*, and *Dillingham* in one respect — the state laws at issue in those cases did not have any impact on whether a particular claimant would receive plan benefits. Here, California law might permit MAC's knowledge to be imputed to UNUM, which could, indirectly, trigger UNUM's obligation to pay Ward's claim. But the fact that state-law agency rules might intersect the administrative process for delivering ERISA benefits is not determinative. In *Mackey v. Lanier Collection Agency & Service, Inc.*, 486 U.S. 825 (1988), the Court held that state-law mechanisms to collect a judgment could be applied against a plan "even when those mechanisms prevent plan participants from receiving benefits." *Id.* at 831-832.

In *Mackey* the United States argued, as it does here, U.S. Br. 27, that the state law must be preempted because its application to ERISA plans would cause them to "incur substantial administrative burdens and costs." 486 U.S. at 831. And the Court in *Mackey* was likewise urged to find preemption lest interstate ERISA plans be subjected to "varying or conflicting state laws." *Id.* at 842 (dissenting opinion). But both arguments were rejected by this Court.

Mackey recognized that ERISA plans were frequently sued for "run-of-the-mill state-law claims" such as unpaid rent, failure to pay creditors, or even torts committed by the plan. 486 U.S. at 833. Yet the Court observed that "these suits, although obviously affecting and involving ERISA plans and their trustees, are not preempted by ERISA § 514(a)." *Id.* The Solicitor General suggested that the textual phrase "relates to" might be subject to situational elasticity: State-law mechanisms to collect judgments would not generally be deemed to "relate

to" ERISA plans (and hence would not be preempted), *except* when those mechanisms "affect whether benefits will be paid to a plan participant." 486 U.S. at 835. The Court found that the text could not support such a distinction:

> [T]here is simply no logical way to construe the English language so that garnishment or attachment laws "relate to" benefit plans when they are invoked by creditors of the beneficiaries, but not when they are by beneficiaries or creditors of the plan itself.

486 U.S. at 836.

The same analysis should govern here. There is no doubt that state agency law principles would apply in the "run-of-the-mill state-law" lawsuits discussed in *Mackey*: For example, in an action for unpaid rent brought by a landlord on the basis of a lease signed by a party alleged to be the agent of a plan insurer. If California's agency principles do not "relate to" the plan when they are invoked in litigation by a putative creditor of the plan, it is hard to see why they would "relate to" the plan in litigation brought by a plan participant.

CONCLUSION

For the reasons given above, the judgment below should be affirmed.

Respectfully submitted,

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